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ABSTRACT

The private corporation leasing arrangement, as a source of school construction funds, is increasingly being used in Indiana; however, the principles are applicable in any state. The private corporation charges a project fee, which represents its maximum anticipated profit. The private corporation obtains the funds for the project; makes the arrangements for the project funds to be used to pay project expenses; helps the school board and administrators obtain the appropriate state agency approval and prepare for hearings with the public and with state agencies; and is responsible for all administrative tasks and for defending the project against legal claims. The school board selects the architect who draws plans according to their specifications. The school board adopts the appropriate resolutions necessary to comply with state law, with bond counsel requirements, and with the requirements of the financial institution. The private corporation oversees project completion according to the plans and specifications and to the satisfaction of the school board and administrators. The school corporation pays the annual lease rental for the duration of the lease period. (Author/MLF)

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SCHOOL BUILDING CONSTRUCTION THROUGH PRIVATE FUNDS IN A SMALL SCHOOL DISTRICT

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When small or large school corporations build new facilities, or additions to facilities, the School Boards and administrators have to make the same kinds of decisions about the building projects. Each Board must decide such things as:

a) Will an addition to an existing facility suffice or will a new building have to be constructed?

b) Which architectural firm should be hired to design the project, and should construction management be used?

c) Where should the addition or new facility be located?

d) Which source(s) of funds should be used to pay for the project costs?

e) What amount of total tax impact will be acceptable to pay for the new construction?

f) Which contractors should be selected to construct the facility?

Therefore, the principles we will discuss here are applicable to both the small and large school corporation. This discussion also uses Indiana's school construction financing laws as a reference base, but again the principles discussed here might be applicable in any State.

In Indiana, there are five sources of funds available for the construction of school facilities. These sources are:

CUMULATIVE BUILDING FUNDS-State statute permits the levying of a maximum $1.25 tax rate against the total assessed valuation of taxable property in the school corporation. The levy from this tax rate may be accumulated and, with a couple

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of exceptions, be used to pay for a variety of construction work. It may also be used to pay for the leasing or renting of facilities used for non-interschool athletic activities.

GENERAL OBLIGATION BONDS-Indiana's Constitution limits the direct indebtedness of taxing units (including school corporations) to two percent (2%) of that unit's total assessed valuation of taxable property.

STATE FUNDS-The State Common School Fund Loan entitles a qualified school corporation to receive up to a maximum $1,500,000 to be used for construction projects, to be repaid at an interest rate of 1% less than a nationally recognized index of municipal bond averages selected by the Commission on General Education. The State also has a Veterans Memorial School Construction Fund Loan for which eligible school corporations may receive up to a maximum $250,000 to be repaid with a service fee of one percent (1%).

LEASING-State statutes also permit a taxing unit to have new construction paid for through a leasing arrangement with either a local school building corporation or with a private corporation. There is no statutory or constitutional limitation on the individual project amount of construction which may be undertaken through the leasing arrangement. There also is no constitutional or statutory limitation on the percentage of the individual project value which can be undertaken in relation to the total assessed valuation of the taxing unit.

Unless the assessed valuation is very large, Cumulative Building Funds and General Obligation Bonds (direct indebtedness obligations) cannot provide a significant amount of funds for a building program. Therefore, in Indiana, it has been necessary for most school corporations to use, when possible, a combination of the aforementioned funding resources to pay for the construction of a facility. Many times, the primary source of funds has been the leasing arrangement, and

increasingly the private corporation leasing arrangement is being used. (In 1974, approximately 11% of all school facilities built with the leasing arrangement was financed through the use of the private corporation method of leasing. Since 1974, approximately 33% of all school construction in Indiana paid for with the leasing arrangement has been through the use of the private corporation leasing method.)

The local school building corporation, and any of its investors, is prohibited by statute from making a profit. However, it sells revenue bonds to obtain the funds to pay for the project expenses, and the investment institutions which purchase the bonds and resell them, make a profit (or could sustain a loss) on the difference between the purchase and resale of the bonds.

The private corporation charges a project (or overhead) fee, which represents its maximum anticipated profit (which could be depleted by greater than anticipated project expenses). Usually, the total project cost will be less with the private corporation leasing arrangement than with the local school building corporation arrangement because the private corporation need not purchase bond insurance insuring payment of the bonds. Also, the private corporation, in contrast to the local school building corporation, does not have to include in the annual rental an amount for such usual annual expenses as trustee fees, auditing fees, legal fees, and a surplus as security for bond principal and interest.

There also are other reasons for considering the private corporation method of leasing. Most School Board members are not familiar with the various State laws governing school construction projects; most usually have had very limited experience with any building construction projects; and most usually have had quite limited or no experience financing the construction of school facilities. Additionally, the time which the Board has available to devote to the

multiplicity of topics presented for its consideration and/or decisions is quite limited and it cannot afford to devote an inordinate amount of time to a building project.

School Administrators - Superintendents, Assistant and Associate Superintendents, and Business Managers - usually are trained and experienced as educators. Most usually are selected as administrators because of their general abilities, not because of an expertise in an area so narrow as school facility construction. A school administrator's experience with construction may be more limited than that of Board members, yet the administrator is expected to represent the School Board throughout the planning and construction of the project, a responsibility for which he may be ill-equipped. The demand on his time availability may allow him to only deal with the most important questions and not with the daily concerns associated with construction. Additionally, in the tenure of an educational administrator, most of his time will be spent planning and coordinating activities related to budgets, curriculum, in-service education, hiring, contract negotiations, public relations, etc., activities which continuously require the attention of the administrator.

In a ten or twenty year period of time, many school corporations will construct no more than one or two buildings. During that time, the School Board membership may change several times, and school administrators may change several times. Therefore, it is not necessary, and probably impractical, for a Board member or educational administrator to develop an expertise in school construction, or to devote an inordinate amount of their time to such an undertaking. The primary attention of the School Board and administrators should be directed toward those activities which are continuous. It is far more economical

for a School Board to use some firm or individual who has a particular expertise to assist the Board and administrators to accomplish a specific task which may never or would infrequently be repeated, and to allow the educational administrator to devote his time to those tasks which require continuous attention. Just as the School Board will hire an architect to develop the drawings and specifications for the construction of a new facility, it should also use a private corporation which is continuously engaged in and is experienced in all areas of financing school construction.

A private corporation, as opposed to the local school building corporation, is continuously engaged in borrowing funds for the construction of public facilities. A private corporation is interested in perpetuating its existence and, therefore, will want to do everything possible to satisfy the client, and develop a good reference for future projects, in contrast to a local school building corporation which is incorporated to build only one facility. The private corporation is interested in protecting its investment by seeing to it that the construction project is completed according to the plans and specifications and to the satisfaction of the School Board and administrators, and therefore, that the school corporation will pay the annual lease rental for the duration of the lease period.

A school corporation which uses the private corporation to pay for the construction of a facility avoids the necessity of having to expend the time and the funds necessary to form a local school building corporation. Using a private corporation avoids potential disagreements between the School Board and local school building corporation officials about such things as selection of architect, building design, building location, color patterns and/or use of carpet, whether or not to place excess project funds into an escrow account or to use them for

additional work, etc. Also avoided is the possible last minute withdrawal of support for the project by the local school building corporation members. The private corporation will support the School Board's desire to build the project because the private corporation is not subject to the same political and social pressures as are members of the local school building corporation, who are residents of the school corporation.

A private corporation need not obtain the funds needed for the project costs through the bidding procedures. Project funds are obtained through a negotiated direct placement of the funding with a financial institution.

This is accomplished through either a construction loan-mortgage arrangement or through the sale of certificates of participation or beneficial interest, which eliminates the need to sell bonds.

A maximum and sufficient amount of funds is included in the total project cost for changes in plans and specifications, and for unforeseen and unknown expenses.

When construction is completed, the unexpended allowances for changes, unforeseen, and unknown expenses can be used for additional construction, can be used to reduce the rental, or can be returned to the school corporation. If the local school building corporation method is used, and unexpended allowances are not used for additional work, the funds are placed in escrow to be used at the termination of the lease period for retirement of bonds, interest payment, and incidental expenses.

The private corporation obtains the funds for the project, makes the arrangements for the project funds to be used to pay project expenses, helps the School Board and administrators obtain the appropriate State agency approvals,

prepare for hearings with the public and with State agencies, is responsible for all administrative minutia on the building project such as preparing all forms, letters, agreements, contracts, which are the responsibility of the owner to provide, assumes responsibility for defending the project against a remonstrance to it, and for obtaining proper settlement for such things as insurance claims, contractor defaults, liens, etc., if they should occur.

The School Board selects the architect who draws the plans according to the School Board's specifications. The School Board adopts the appropriate resolutions necessary to comply with State law, with bond counsel requirements, and with the requirements of the financial institution.

Using a private corporation eliminates the suspense, and real possibility, of not receiving bids for the local school building corporation revenue bonds on the date(s) they are offered for sale, and eliminates having the bids for the bonds be subject to the economic conditions existing on that one particular date when bids are received for the bonds.

The administrative tasks for the building project are the responsibility of the private corporation. This allows the School Board and administrative officials to have more time to spend on other matters with which they are more familiar and more expert than with a building project, and which certainly are of greater day-to-day concern to school patrons than is the construction of a building.

In summary, the private corporation leasing arrangement offers economical and competitive lease rentals, as well as services and an expertise which have an incalculable value.